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HAROLD B. WILLEY,

IN THE

Supreme Court of the United States

October Term, 1954

No. 548

EUGENE SMALDONE and CLYDE SMALDONE, *Petitioners,*

v.

UNITED STATES OF AMERICA, *Respondent.*

Petition for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

REPLY BRIEF FOR PETITIONERS

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1954

No.

JAMES F. FOGARTY, HERBERT C. FREEMAN, CHRISTIAN A. JOHNSON, DAVID G. MCCORNACK, JOHN H. ECCLES and HUGH B. BAKER,

Petitioners,

against

CARL J. AUSTRIAN and ROBERT G. BUTCHER, as Trustees of Central States Electric Corporation,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioners, defendants in this plenary action commenced against them by respondents, as plaintiffs, in the District Court of the United States for the Southern District of New York, respectfully pray that a writ of certiorari issue to review a judgment of the United States Court of Appeals for the Second Circuit, reversing a judgment of the United States District Court for the Southern District of New York which granted petitioners' applications, made in this action pursuant to a statute of the State of New York,[1]

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[1] Article 6-A, secs. 64-68, General Corporation Law of New York; 22 McKinney's Consol. Laws c. 23; L. 1945 c. 869, in effect April 18, 1945.

for the assessment of their reasonable expenses, includin attorneys' fees, incurred by petitioners in their succes ful defense of this action. The Court of Appeals directe dismissal of petitioners' applications for lack of jurisdi tion in the District Court, without prejudice to renewal o the application in the United States District Court fo the Eastern District of Virginia, where the debtor, Cen tral States Electric Corporation, has been in proceeding for reorganization under Chapter X of the Bankruptc Act.[2]

Opinions Below

Both the original opinion and the opinion on reargumen of the Court of Appeals (Clark, Hincks, and Harlan, Circui Judges) are reported in 216 F. 2d 278. The opinion of th Dis'rict Court (Weinfeld, D. J.) granting petitioners' appli cation for the assessment of their reasonable expenses i printed at page 75a of the Consolidated Appendix in th Court of Appeals and is reported in 120 F. Supp. 900 Copies of the opinions of the Court of Appeals are printed in the Appendix to this petition.

Jurisdiction

Jurisdiction of this Court is invoked under Sec. 1254(1) of the Judiciary Code.[3] The judgment of the Court of Appeals after reargument was entered October 19, 1954. The order granting rehearing was made July 23, 1954.

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[2] 11 U.S.C.A. secs. 501-676; Act of June 22, 1938, as amended, 52 Stat. 839, as amended.

[3] 28 U.S.C.A. sec. 1254(1); Act of June 25, 1948, sec. 1, 62 Stat. 869.

Questions Presented

1) Where a district court has jurisdiction under Chapter II, Sec. 2a(7) of the Bankruptcy Act[4] of a plenary action brought by trustees of a debtor corporation in reorganization under Chapter X of the Bankruptcy Act against defendants, residents of the state in which the district court sits, to enforce rights created by the laws of that state, and the action is dismissed on the merits as against such defendants, does the district court in which the action was brought and determined also have jurisdiction of applications, pursuant to the laws of the state, for the assessment of the defendants' reasonable expenses, including attorneys' fees, incurred in their successful defense of the action?

2) Does the decision of the Court below conflict with the earlier decision of the same Court in *Austrian, et al., Trustees* v. *Williams, et al.* (Swan, Augustus N. Hand, and Clark, Circuit Judges) 159 F. 2d. 67, and of the decision of this Court in *Williams, et al.* v. *Austrian, et al., Trustees* (Justices Frankfurter and Jackson dissenting), 331 U. S. 642, sustaining the jurisdiction of the District Court for the Southern District of New York over this plenary action under Chapter II, Sec. 2a(7) of the Bankruptcy Act?

3) Do the provisions of Chapter II, Section 2a, particularly sub-divisions (2), (7), (15) and (18), and 2b of the Bankruptcy Act[5] confer jurisdiction upon the District Court for the Southern District of New York to hear and determine petitioners' applications for assessment of their

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[4] 11 U.S.C.A. sec. 11(a)(7); as amended July 7, 1952, c. 579, sec. 2, 66 Stat. 420.

[5] *Supra*, note (4).

reasonable expenses, including attorneys' fees, incurred in their successful defense of this action?

4) Do the expenses incurred by defendants, former officers or directors of a debtor corporation, in the successful defense of this action constitute "costs and expenses in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization" of the debtor corporation within the meaning of Sec. 221(4) of the Bankruptcy Act?[6]

5) Where the final judgment of the District Court for the Southern District of New York, dismissing this action on the merits, as against petitioners, as defendants, included a reservation of jurisdiction for the purpose of "assessing costs and expenses of the parties" and that District Court has granted a further supplemental judgment awarding these petitioners their reasonable expenses incurred in the successful defense of this action which contained no direction for the enforcement or payment thereof, the Court saying "That is a matter for the Bankruptcy Court [*i.e.* the District Court for the Eastern District of Virginia].", do the provisions of Section 111 or Section 221(4) of Chapter X of the Bankruptcy Act,[7] or the decisions of this Court in *Brown* v. *Gerdes*, 321 U. S. 178, or *Leiman* v. *Guttman*, 336 U. S. 1, prevent the District Court for the Southern District of New York from having jurisdiction to determine petitioners' applications for such expenses and confer exclusive jurisdiction of such applications on the District Court for the Eastern District of Virginia?

6) Do the provisions of a state statute providing for the assessment against a corporation doing business in

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[6] 11 U.S.C.A., sec. 621(4); 52 Stat. 897.

[7] 11 U.S.C.A., secs. 511, 621(4); 52 Stat. 884, 897.

the state for litigation expenses incurred by defendants in the successful defense of an action in which such defendants were made parties by reason of the fact that they were formerly directors of such corporation, condition the state-created rights attempted to be enforced in such action and are they, therefore, applicable in the federal district court under *Cohen* v. *Beneficial Loan Corp.*, 337 U. S. 541?

7) Where, after a plan of reorganization of the debtor corporation has been confirmed and a separate fund has been set aside for the expenses in connection with a plenary action, does the district court in which such action has been tried and determined have jurisdiction to grant allowances to the successful defendants, pursuant to a state statute, for their reasonable expenses and direct judgment therefor without including therein any direction for payment?

8) Did the Circuit Court of Appeals err in reversing the judgment and decision of the District Court granting petitioners allowance for their expenses and affirming the District Court's order vacating a separate judgment in favor of petitioners Fogarty and Freeman?

The Statutes

The statutory authorization for this plenary action against petitioners, as former officers or directors of the debtor Central States Electric Corporation, and for the bringing of this action by the respondents, as trustees in bankruptcy of the debtor corporation, are found in the provisions of Article 6, Sections 60 and 61 of the General Corporation Law of New York; McKinney's Consol. Laws, c. 23; L. 1929, c. 650, as amended L. 1944, c. 727 and L. 1946, c. 162. The petitioners' applications for assess-

ment of their reasonable expenses incurred in the succes
ful defense of this action were made pursuant to the pro
sions of Article 6-A, Sections 64-68 of the General Corpor
tion Law of New York; McKinney's Consol. Laws, c. 2
L. 1945, c. 869, §4, in effect April 18, 1945. The pertine
provisions of the Bankruptcy Act relating to the juri
diction of the District Courts of the United States
courts of bankruptcy are in Chapter II, Section 2 of t
Bankruptcy Act, 11 U. S. C. A., Section 11, as amend
by the Act of July 7, 1952, c. 579, §2, 66 Stat. 420. T
pertinent provisions of the Bankruptcy Act relating
reorganizations of debtor corporations, plans of reorga
zation and the powers of a district judge of the distri
court in which such reorganization proceedings are pen
ing are in Chapter X of the Act, 11 U. S. C. A. 501-67
Act of June 22, 1938, 52 Stat. 839. The foregoing statuto
provisions being lengthy, their pertinent texts are s
forth in an appendix to this petition.

Statement of the Case

Central States Electric Corporation is a Virginia co
poration and was doing business at an office in New Yo
until on February 23, 1942, a petition for its reorganizati
as a debtor under Chapter X of the Bankruptcy Act w
filed in the United States District Court for the Easte
District of Virginia. An order approving the petition w
entered February 27, 1942. The respondents were a
pointed successor trustees of the debtor corporation up
the resignation of the original trustees.

After an extensive investigation of the affairs of t
debtor corporation,[8] with the approval and authoriz

[8] The investigation was made pursuant to the decision in *Co*
mittee for Holders, etc. v. *Kent, et al., Trustees,* 143 F. 2d 684 (C.C.
4th, 1944).

tion of the District Court in Virginia, respondents commenced this plenary action in July, 1945, against petitioners and others to recover approximately $30,000,000 as the amounts claimed to be due the debtor corporation by reason of the alleged failure of petitioners and others to perform their fiduciary duties as officers or directors of the debtor corporation in relation to thirteen separate transactions, all of which took place during the years 1922 through 1938 in New York.

Petitioners are residents of New York and were either officers or directors of the debtor corporation for different terms during the above-mentioned period.

The debtor corporation, as a foreign corporation doing business in New York, could have maintained this action against petitioners and the other defendants, upon authorization of the reorganization court, either in the state court in New York or in the District Court for the Southern District of New York, and the jurisdiction of the latter Court could have been grounded upon the diversity of citizenship of the parties.

However, in the complaint, respondents, as plaintiffs, did not allege facts showing diversity of citizenship, but relied upon the federal constitutional and statutory provisions relating to bankruptcy as grounds for jurisdiction of this plenary action in the District Court in New York.

Petitioners and other defendants thereupon moved in the District Court in New York for judgment dismissing the complaint for failure to state facts requisite to confer jurisdiction on that District Court, pointing out the absence of allegations showing diversity of citizenship. The District Court granted petitioners' motion and dismissed the complaint for lack of jurisdiction (*Austrian* v. *Williams*, 67 F. Supp. 223, Leibell, D. J.). On appeal by respondents to the Court of Appeals for the Second

Circuit, the judgment of the District Court was reversed and the jurisdiction of the District Court was sustained, the Court of Appeals having construed the provisions of Section 2a(7) of the Bankruptcy Act[9] as sufficiently broad to confer upon the District Court in New York, as a bankruptcy reorganization court, jurisdiction over this plenary action (*Austrian* v. *Williams*, 159 F. 2d 67, Swan, Hand and Clark, Circuit Judges). Petitioners and other co-defendants applied to this Court for a writ of certiorari, which was granted (330 U. S. 813), and on review by this Court the determination of the Court of Appeals was sustained (*Williams, et al.* v. *Austrian et al., Trustees, supra*).

Thereafter petitioners and other co-defendants moved in the District Court at a term for motions for judgment dismissing the action upon the ground that it was barred by the New York Statute of Limitations. Those motions were denied without prejudice to renewal before the trial court (*Austrian* v. *Williams*, 80 F. Supp. 437, Coxe, D. J.). That order, not being a final determination, was not appealable.

The action was tried in the District Court in November and December of 1951 and after a lengthy trial, on March 7, 1952, judgment was entered dismissing the action on the merits as against petitioners and granting a partial judgment in favor of respondents and against the co-defendants Williams and Kilmarx[10] (*Austrian, et al.* v.

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[9] *Supra*, note (4).

[10] The co-defendant Williams was not a director of the debtor corporation, but was the holder of a majority of the outstanding common stock of the corporation. The complaint charged, among other things, that Williams dominated and controlled the debtor corporation and its officers and personally profited in certain transactions of the debtor corporation. The co-defendant Kilmarx was a director of the debtor corporation from March 22, 1922 until the filing of the petition for the reorganization of the debtor and held various offices, including the office of President from March 6, 1923 to July 3, 1929 and Vice President from July 3, 1929 to the filing of the petition for reorganization.

Williams, et al., 103 F. Supp. 64, original opinion, January 10, 1952, by Weinfeld, D. J.).

The District Court held that respondents had failed to prove the greater part of the thirteen separate transactions as against petitioners and that the claims based upon the remaining transactions were barred by the New York Statute of Limitations.[11] The judgment of dismissal included, among others, the following provision:

> "11. The parties hereto may hereafter apply herein to this Court for such further orders and directions as may be just and proper in connection with costs, expenses and allowances, and with the enforcement, adjustment and satisfaction of this judgment and decree, and the Court retains jurisdiction for such purpose."

Respondents did not appeal from any part of the judgment of dismissal on the merits in favor of these petitioners.

However, the co-defendants Williams and Kilmarx appealed from the partial judgment against them and on that appeal the Court of Appeals reversed the judgment of the District Court and held that the claims against those co-defendants were also barred by a proper application by the District Court of the New York Statute of Limitations, as construed by the appellate courts of New York (*Austrian, et al.* v. *Williams, et al.*, 198 F. 2d. 697, Swan, Chief Judge and Chase, Circuit Judge; Clark, Circuit Judge, dissenting). Certiorari was denied by this Court[12]

On the mandate of the Court of Appeals, the District Court entered a judgment in favor of the co-defendants Williams and Kilmarx and, in accordance with the mandate, included, among other things, a direction for judg-

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[11] 103 F. Supp. 67, at p. 117.

[12] 344 U. S. 909.

ment in favor of such co-defendants for costs in the amount of $3,686.65.

Following the conclusion of the foregoing proceedings and appeals, and exercising their rights under the reservation of jurisdiction in paragraph 11 of the judgment of dismissal, quoted above, these petitioners made application in this action pursuant to the provisions of Article 6-A, Secs. 64-68 of the General Corporation Law of New York,[13] for the assessment in this action of their reasonable expenses incurred in their successful defense of this action. These applications were heard and granted by the District Court (*Austrian, et al.* v. *Williams, et al.*, 120 F. Supp. 900, August 21, 1953, Weinfeld, D. J. (R. 75a)).[14]

By an order dated October 17, 1953, the Court assessed the petitioners' expenses against the debtor, Central States Electric Corporation, in varying amounts aggregating $41,000, as attorneys' fees, and $1,185.53 as disbursements of petitioners Fogarty and Freeman, or a total of $42,185.53 (R. 90a).

On application to the Clerk of the District Court, a separate judgment was entered November 4, 1953, in favor of petitioners Fogarty and Freeman for the total amount of $31,185.53, with interest thereon, at the rate of 6% per annum from March 7, 1952, the date of the entry of the final judgment in this action in favor of petitioners dismissing the complaint on the merits, said interest amounting to $3,111.29, or for the total sum of $34,296.82 (R. 91a). Petitioners Fogarty and Freeman appealed from the order of the District Court vacating that separate judgment (R. 115a).

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[13] *Supra*, note (1).

[14] References are to pages of the Consolidated Appendix in the Court of Appeals.

Respondents appealed to the Court of Appeals for the Second Circuit. That Court, relying upon the decisions of this Court in *Brown* v. *Gerdes*, 321 U.S. 178 and *Leiman* v. *Guttman*, 336 U. S. 1, held that the District Court was without jurisdiction to determine the applications of petitioners and directed that the applications be dismissed, without prejudice to renewal in the District Court for the Eastern District of Virginia which was held to have exclusive jurisdiction over the petitioners' applications for allowances, even though made under the New York Statute which requires that the applications be made "in the action" or if not so made, then by a special proceeding in the Supreme Court of New York (*Austrian, et al., Trustees* v. *Williams, et al.*, 216 F. 2d 278, Clark, Hincks and Harlan, Circuit Judges).

Petitioners requested reargument of the appeal, pointing out that the question of jurisdiction had not been raised or argued on the original appeal and that the decision of this Court in *Brown* v. *Gerdes, supra*, involved allowances for attorneys of trustees in reorganization, and in *Leiman* v. *Guttman, supra*, allowances to an attorney for a committee of security holders, both of which allowances were under the exclusive jurisdiction of the judge of the Bankruptcy Court where the petition for reorganization was filed, as expressly provided in Section 221(4) of the Bankruptcy Act,[15] and also urging that the decision of the Court of Appeals conflicted with the earlier decision of the same Court of Appeals and of this Court sustaining the jurisdiction of the District Court in New York over this plenary action under the provisions of Section 2a(7) of the Bankruptcy Act (*Austrian* v. *Williams, supra*, opinion by Clark, C. J., 159 F. 2d. 67, aff'd

[15] 11 U.S.C.A. sec. 621(4), Act of June 22, 1938, c. 575 sec. 1, 52 Stat. 897.

Williams, et al. v. *Austrian, et al., Trustees, supra,* 331 U. S. 642).

Reargument was granted and after reargument, the Court of Appeals adhered to its original decision holding that the prior decisions sustaining jurisdiction of the District Court over this plenary action did not "reach the question" of the District Court's jurisdiction over petitioners' applications for assessment of expenses.[16]

In the opinion on reargument the Court further held that petitioners' expenses arising out of this action were "in connection with a plan and incident to the reorganization" of the debtor corporation and were "fixable after confirmation of the plan" and were, therefore, "subject to the approval of the [reorganization] judge".[17] The Court also made specific reference to the provisions of Section 221(4) of the Bankruptcy Act[18] which had not been mentioned in the original opinion.

Although the Court noted in its original opinion that the plan of reorganization of the debtor "has been finally approved and consummated *except* for the winding up of the action against the Central States directors * * *" and that "Funds were also reserved in the hands of the Trustees to provide for 'allowances and expenses * * * in retaining and enforcing the contingent assets of the Estate, and in distributing the proceeds thereof'," the Court indicated in its opinion on reargument that the allowance of petitioners' expenses "may have an impact upon the administration of an estate or a plan of reorganization" and that, therefore, it would not follow from the filing of this suit in the New York District Court that

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[16] 216 F. 2d 278, at p. 283.

[17] 216 F. 2d, 278, at pages 284-285.

[18] *Supra*, note (15).

such Court would have jurisdiction to determine the liability for petitioners' expenses. The Court further added that it did not mean to express any view as to the validity of petitioners' state-created right to reimbursement for their litigating expenses or the enforceability of that right "in a federal court of competent jurisdiction." The Court adhered to its original decision, saying "only the Reorganization Court has jurisdiction to determine and enforce the right to reimbursement".

REASONS FOR GRANTING THE WRIT

I

The Court of Appeals has decided an important question of substantive federal law relating to the distribution between different federal district courts of the judicial powers conferred by the provisions of the Bankruptcy Act, which has not been, but should be, decided by this Court.

The decision below accomplishes two important jurisdictional determinations, (1) it withdraws from the jurisdiction of the Southern District Court in New York the power to hear and determine petitioners' applications for their litigation expenses and render judgment therefor, although the District Court made no provision for the enforcement thereof, the District Court holding that a matter for the Virginia District Court; and (2) it purports to confer exclusive jurisdiction of petitioners' applications on the District Court in Virginia, which authorized the filing of this action in New York and which has approved a plan for the reorganization of the debtor and set aside a fund for the

expenses of this litigation. Thus, a Court of Appeals in one circuit (*i.e.* the Second Circuit) has undertaken to decide not only the jurisdictional powers of a district court in its circuit, but also the jurisdictional powers of another district court in a different circuit. The latter determination, of course, is not binding on the Virginia District Court or the Court of Appeals for the Fourth Circuit. This, we respectfully submit, is a matter calling for decision by this Court.

The reversal by the Court below of the judgment of the New York District Court is based solely on the fact that a reorganization plan for the debtor corporation has been approved in another district court. But there is absent here any showing that the determination of petitioners' applications for their litigation expenses is governed by any provision of the Bankruptcy Act, or that it has interfered with the administration of the debtor's estate in the Virginia Court, or has affected the plan of reorganization in any material way, or that the amounts of petitioners' expenses as fixed by the New York Court exceed the amount of the fund set aside for expenses of this action by the Virginia Court. The decision below, therefore, was made upon an important question of the law governing the jurisdiction of the district courts in different circuits which calls for an authoritative interpretation of a federal statute by this Court.

In *Callaway* v. *Benton*, 336 U. S. 132, at page 142, this Court has said: "There can be no question, however, that Congress did not give the bankruptcy court exclusive jurisdiction over all controversies that in some way affect the debtor's estate." There, the question was whether a federal bankruptcy court in which a debtor railroad corporation was in reorganization under Section 77b of the Bank-

ruptcy Act [19] could enjoin an action in a state court by the stockholders of another corporation which, though the lessor of the debtor's leased properties, was not in reorganization. Similar situations were considered by this Court in *Arkansas Corporation Commission* v. *Thompson*, 313 U. S. 132 and *Gardner* v. *New Jersey*, 329 U. S. 565. This Court has also said [20] that "Even when the controversy involves property within the exclusive jurisdiction of the bankruptcy court, that court may, in its discretion, postpone action pending adjudication of the question in another court," citing *Ex parte Baldwin*, 291 U. S. 610; *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478; *Order of Railway Conductors* v. *Pitney*, 326 U. S. 561; *Foust* v. *Munson S. S. Lines*, 299 U. S. 77; *Railroad Commission* v. *Pullman Co.*, 312 U. S. 496; *Chicago* v. *Fieldcrest Dairies*, 316 U. S. 168.

The issue here does not involve the question of the conflicting jurisdictions of state courts and federal courts on which this Court has written extensively, but it does present an important question of the application in the federal courts of a state law to state-created rights and the further question of the restrictions and limitations of the respective jurisdictions of different federal district courts under the powers conferred under the Bankruptcy Act.

Since the decision of this Court in *Williams, et al.* v. *Austrian, et al., Trustees, supra,* [21] sustaining the jurisdiction of the New York District Court over this plenary action under Section 2a(7) of the Bankruptcy Act, [22] there has been no decision of this Court which clarifies the re-

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[19] 49 Stat. 911; 11 U.S.C., Sec. 205.

[20] 336 U. S. 132 at p. 142, footnote (11).

[21] 331 U. S. 642.

[22] 11 U.S.C.A., Sec. 11, 30 Stat. 545, as amended 52 Stat. 842, 66 Stat. 420.

spective jurisdictions of different district courts as bankruptcy reorganization courts, in situations such as presented here. One District Court, as a bankruptcy reorganization court, having jurisdiction of the estate of a debtor corporation which conducted its business in another jurisdiction, appointed Chapter X trustees of the debtor corporation and authorized the trustees to bring suit in another District Court and the jurisdiction of such suit is founded upon the broad powers of Section 2 of the Bankruptcy Act, notwithstanding that the matter in suit involved state-created rights, and the defendants are all residents of such state. The action has been determined on the merits against the trustees by the local District Court according to the state law, thereby creating a liability of the debtor's estate under the state law for the litigation expenses of the successful defendants which, by the terms of the state law, must be assessed "in the action" and the local District Court, on applications addressed to it, has determined the amount of such expenses without provision for payment, in deference to the reorganization court.

One of the important questions raised by the decision below is whether in the disposition of the local action (which, of course, was a determination of one of the "controversies" in relation to the bankrupt's estate within the provisions of Section 2a(7) of the Bankruptcy Act), the powers and functions of the local District Court, as a court of bankruptcy, are substantially the same as they would be in cases where the jurisdiction of the local District Court is founded upon the diversity of citizenship of the parties.

Throughout the long history of this "unusually complicated case,"[23] beginning with the decision of the Court of

[23] See *Austrian* v. *Williams*, 103 F. Supp. 64 at p. 69, footnote to opinion of District Judge Weinfeld.

Appeals for the Fourth Circuit, overruling an order of the reorganization court which approved the recommendations of the original trustees against the filing of this suit,[24] and at every subsequent stage of this action, the most diligent effort has been made by the present trustees to have this controversy determined upon federal equity doctrines, primarily to avoid the application in the New York District Court of the state law, including the state statute of limitations. In the determination of this action that effort has failed completely.[25] Nevertheless, that same effort has been continued in opposing the petitioners' applications and it is reflected in the decision and original opinion of the Court below: "the State statute must yield to the supremacy of the bankruptcy laws."[26]

Unlike the opinion of this Court in its earlier decision in *Williams, et al.* v. *Austrian, et al., Trustees, supra,* the decision of the Court below does not disclose any analysis of the problem of state law in the federal courts or a comparison of the provisions of Chapter II, Section 2, and Chapter X, Section 221(4) of the Bankruptcy Act. Such an analysis, we submit, is essential to a proper determination of the respective powers and functions of the local District Court in making the assessments of petitioners' expenses and of the judge of the Reorganization Court in approving the plan of reorganization.

Chapter II, Section 2 is the important provision of the Bankruptcy Act which creates the courts of the United States "as courts of bankruptcy" and vests them in proceeding under the Act "with such jurisdiction at law and

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[24] *Committee for Holders, etc.* v. *Kent, et al., Trustees,* 4th Cir. 143 F. 2d 684 at p. 685.

[25] See *Austrian* v. *Williams,* 2nd Cir., 198 F. 2d, 697; cert. den'd, 344 U.S. 909.

[26] 216 F. 2d 278 at p. 285.

in equity as will enable them to exercise original jurisdi tion" in twenty-one separately defined specific matter These include, among others, the power to "(2) Allo claims * * *; (3) * * * commence and prosecute an suit or proceeding in behalf of the estate before an judicial * * * tribunal in any jurisdiction * * * (7) Cause the estates of bankrupts to be collected, re duced to money and distributed, and determine contro versies in relation thereto, except as herein otherwis provided * * *; (15) Make such orders * * * an enter such judgments * * * as may be necessary fo the enforcement of the provisions of this Act * * * (18) Tax costs and render judgments therefor agains the unsuccessful party * * * and against estates, i proceedings under this Act; * * *."

That the broad scope of the powers is not limited b the twenty-one specifically designated powers is indicate by subdivision b of Section 2 which reads: "b. Nothin in this section contained shall be construed to deprive court of bankruptcy of any power it would possess wer certain specific powers not herein enumerated."

Chapter X contains the provisions relating to the filin of petitions for reorganization of debtors and the approva of plans for reorganization. The particular section t which the present controversy relates is Section 221.[27]

The present controversy has to do with the provision of subdivision (4) of this section.

In the performance of the function of the district courts as courts of bankruptcy in plenary actions, and of th judge of a reorganization court in confirming a plan unde Section 221, it is, of course, of the greatest importanc that all the district courts shall have the benefit of a con trolling decision of this Court for their guidance.

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[27] (11 U.S.C.A., §621). The complete text is printed in th Appendix at page 37.

The provisions of Section 2 have been a part of the Bankruptcy Act since 1867.[28] It was continued in substantially the same language in the Act of 1898.[29] Chapter X did not become a part of the Bankruptcy Act until the Chandler Act of 1938,[30] which generally revised the 1898 Act and made Section 23 inapplicable in reorganization proceedings under Chapter X unless an order is entered directing that bankruptcy be proceeded with pursuant to the provisions of Chapters I to VIII, inclusive.[31]

The determination by a controlling decision of this Court should include answers, among others, to the following questions:

Are such litigation expenses of the successful defendants actually "expenses in connection with" the reorganization proceeding or plan of reorganization within the meaning of subdivision (4) of Section 221?

May the judge confirming a plan under Section 221 be "satisfied" regarding the payments specified in subdivision (4) only if that judge conducts the hearing and makes the determination on all controversial applications for payments which are a charge against the assets of the debtor corporation; or may that judge be "satisfied", within the meaning of Section 221, where another district court, as a bankruptcy court, has heard and made a judicial determination of applications for litigation expenses of successful defendants in defending an action instituted by the trustees in such other district court which has also tried the action and in that action made the determination regarding the liability of the trustees for such expenses and the reasonable amount thereof?

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[28] In the Act of 1867 it was Sec. 1, 14 Stat. 517.

[29] 30 Stat. 544, as amended.

[30] 52 Stat. 840.

[31] Section 102 of the Act; 11 U.S.C.A., sec. 502, 52 Stat. 883.

A literal reading of subdivision 4 of Section 221 does not embrace such expenses, nor require the judge of the reorganization court to take over the function and the burden of hearing and determining a petition for successful defendants' expenses which obviously can be determined more accurately and fairly by the district court in which the action was tried. Comity between federal district courts should suffice to enable the judge of the reorganization court to accept the determination of another district court, also sitting as a court of bankruptcy, and thereby meet any requirements for the satisfaction and approval by the judge of the reorganization court, both as to the legal liability of the debtor's estate for such expenses and reasonableness thereof.

The decisions of this Court on which the Court below relied are *Brown* v. *Gerdes*, 321 U. S. 178 and *Leiman* v. *Guttman*, 336 U. S. 1.

Brown v. *Gerdes* involved the question whether the fees of attorneys employed to represent a debtor's estate in litigation in a state court could be fixed by that court or the federal bankruptcy court where the debtor corporation was in reorganization under Chapter X. Both the New York Court of Appeals (290 N. Y. 468) and this Court held that under Section 221(4), as well as Section 241(3)[32] of Chapter X of the Bankruptcy Act, the federal court had exclusive jurisdiction. The opinion of this Court (by Justice Douglas) includes a full discussion of the history and the purposes of Chapter X and the "detailed machinery governing all claims for allowances from the estate" contained in Chapter X. But the issue decided in *Brown* v. *Gerdes* was whether the state court or the federal bankruptcy court was vested with power to fix the fees

[32] 11 U.S.C.A., Sec. 641, 52 Stat. 900.

of attorneys employed by the debtor's estate. The ruling of this Court was that under the Constitutional power (Art. I, Sec. 4) to establish uniform laws on the subject of bankruptcies throughout the United States, Congress had conferred sole jurisdiction on the judge of the federal bankruptcy reorganization court. The case involved no question regarding the distribution of bankruptcy powers between two federal district courts or the expenses of defendants in the successful defense of a plenary action against them by a Chapter X trustee in a federal district court.

Likewise, *Leiman* v. *Guttman, supra,* involved claims for services of the attorneys for a stockholders' protective committee in connection with the reorganization of a debtor under Chapter X of the Bankruptcy Act. Payments for such services are, of course, plainly within the provisions of Sections 242(1) and (3) and 221(4)[33] as payments for services in connection with the reorganization proceeding and incident to the reorganization, as well as the plan, and were, therefore, within the jurisdiction of the judge of the district court, irrespective of the fact that the actual payment was to be made from a source other than the debtor's estate.

It is pertinent here to note that in the opinion in the *Leiman* case, this Court said (336 U. S. 1, at p. 9):

> "• • • Moreover, it is the bankruptcy court that is in the best position to know what work was done by the fee claimant, how important and involved it was, how much it benefited the whole group of security holders and how much it benefited the one class alone, how much of it was necessary, how much of it was effective. That court has already determined what the estate should pay. The ques-

[33] 11 U.S.C.A., Secs. 621 and 642, 52 Stat. 900.

tion that remains is how much of a charge should
made against the escrowed stock and whether t
state court or the bankruptcy court should determi
what that charge should be. Certainly where, as
this case, the services benefited in part the esta
and in part one class of security holders, it is t
bankruptcy court that is in the position to weig
the interrelated issues of fact and make a fair a
location between the two.

"These practical considerations support the li
eral reading of §221(4) that it is the bankrupt
court that has jurisdiction to pass on these fee
Its jurisdiction is therefore exclusive. See *Brou*
v. *Gerdes, supra.*"

There is, we submit, a striking similarity in the reaso
ing of the District Judge in rejecting the trustees' co
tention that the fixing of allowances by the New Yor
District Court would be an invasion of the bankrupt
powers of the Virginia reorganization court. In the opi
ion by Judge Weinfeld it was said (R. 88a):

"• • • This Court is entirely familiar with th
services for which reimbursement is sought and ca
more readily appraise their value than a Court no
so situated and which would be compelled to rel
upon extensive affidavits. Moreover, this Cour
having conducted the trial, can make its appraisa
upon its own knowledge, without extended proof,
course which would be inevitable were the proceed
ings brought in the Bankruptcy Court. No vali
reason exists for imposing such a burden upon th
Bankruptcy Court or the applicants. Presumabl
the New York statute provides for the making o
the application in the action because of these con
siderations."

The reasons stated by the District Court in New Yor
to sustain its jurisdiction appear to be fully in accord wit

the views expressed by Justice Douglas, writing for this Court in the *Leiman* case.

There is, therefore, a serious doubt whether in reversing the District Court the Court below properly interpreted this Court's decisions in the *Leiman* case and in *Brown* v. *Gerdes*.

On the reasoning of the Court below, basing its decision, as it does, on Section 221 (4) of the Bankruptcy Act and the *Leiman* case, the amounts which petitioners would be required to pay out of their own funds for their own counsel in defending this plenary action would have to be passed upon by a judge of the reorganization court, regardless of any right of reimbursement for such expenses. By adopting the view that such expenses are an "incident" of a reorganization plan, the decision below means that any expenses incurred by defendants in any plenary suit brought by a Chapter X trustee necessarily requires the approval of the reorganization judge as a condition of their payment, even though not payable out of the debtor's estate.

Moreover, if the decision of the Court below is permitted to stand, the litigation expenses for the defense of a plenary suit brought by Chapter X trustees, although involving entirely different issues of fact and law, will have to be treated in the same forum and in the same manner as expenses incurred in connection with a reorganization plan. This would not only impose an additional burden upon the judge of the reorganization court, but would require that judge to make a determination which, as a practical matter, the court in which the plenary suit was brought is uniquely qualified to make.

II

The Court of Appeals has decided a federal question in a way which conflicts with the decision of this Court in *Williams, et al.* v. *Austrian, et al., Trustees*, 331 U. S. 642.

The Court of Appeals, particularly in its original opinion, has overlooked that in *Williams, et al.* v. *Austrian, et al., Trustees, supra*,[34] this Court dealt fully with the question of the jurisdiction of the District Court in New York over this plenary action and that this Court sustained the jurisdiction of that Court under the broad provisions of Section 2a(7) of the Bankruptcy Act. There, referring to the absence of allegations showing diversity of citizenship of the parties as the basis for federal jurisdiction and reviewing the provisions of the Bankruptcy Act, this Court said (331 U. S. at pp. 657-658):

> "• • • Congress intended by the elimination [from reorganization proceedings] of §23 to establish the jurisdiction of federal courts to hear plenary suits brought by a reorganization trustee, even though diversity or other usual ground for federal jurisdiction is lacking.
>
> "The decision of the Circuit Court of Appeals is in entire harmony with the foregoing considerations. The language of §2, in its ordinary sense and no longer limited by §23, easily comprehends the present type of suit; • • • Since all reorganization courts are the objects of the jurisdiction conferred by §2, the District Court for the Southern District of New York has jurisdiction to hear the present suit, • • •"

And, further, at pp. 660-661:

> "• • • Because of the countrywide ramifications of corporate debtors placed in Chapter X re-

[34] 331 U.S. 642.

organization, it is as usual as not for the trustee to resort to foreign jurisdictions for the disposition of plenary suits. Allowing the primary court to hear these suits will not change this situation, if it is true that the process of a reorganization court does not run nationwide in plenary cases * * *.

"Our holding is, of course, that Congress in 1938 extended the jurisdiction of the reorganization courts beyond that exercised by ordinary bankruptcy courts. * * * But the exception to §2a(7) acknowledged the overriding limitations of §23, which was the embodiment of Congressional policy to exclude from the bankruptcy courts many of the trustee's plenary suits. * * * The failure to provide appropriate fanfare for the suspension of §23 in Chapter X cases, and for the consequent expansion of federal jurisdiction, hardly invites our opinion as to the advisability of the action which Congress has taken. Judicial drives to limit the jurisdiction of federal courts should not lead to decision falling short of complete effectuation of statutory scheme. With the limitations of §23 suspended, §2 confers jurisdiction upon all reorganization courts to hear plenary suits brought by a Chapter X trustee."

* * *

We respectfully submit that upon a fair reading of this Court's opinion on the issue of jurisdiction of the District Court in New York in the above case, especially in the light of the strong dissenting opinion of Justice Frankfurter, the reasonable inference is that the District Court in New York is authorized under Section 2 of the Bankruptcy Act to exercise plenary jurisdiction to the same extent as if jurisdiction had been founded upon diversity of the citizenship of the parties. We further submit that nothing held by this Court in *Williams* v. *Austrian* indicates any restriction on the power of the District Court

in New York to exercise all the necessary jurisdiction to hear and determine each and every part, as well as every incident of this plenary action, including the incident of petitioners' applications for assessment of their expenses incurred in the successful defense of such plenary action.

The decision below cannot, we submit, be reconciled with the earlier decision of this Court and of the Court of Appeals sustaining the jurisdiction over this plenary action under Section 2 of the Bankruptcy Act.

III

The Court of Appeals has decided an important question of substantive federal law concerning federal and state relations in connection with plenary suits brought by Chapter X trustees which has not been, but should be, decided by this Court.

In the opinion on reargument, the Court below rejected petitioners' contention that the bringing of this suit in the Southern District Court of New York operated to confer jurisdiction on that Court to hear and determine petitioners' applications and that the state statute providing for the assessment of petitioners' expenses was a condition of respondents' right to sue. Petitioners relied upon the rationale of *Cohen* v. *Beneficial Loan Corp.*, 337 U. S. 541. In rejecting petitioners' contention the Court below invoked the supremacy of the bankruptcy laws over the state statute.

In contrast, the earlier decision of the Court of Appeals (differently composed except for Circuit Judge Clark, who dissented) rejected the urgent contentions of the respondents that a federal doctrine of limitations, not the state law of limitations, should be applied (*Austrian* v. *Williams*, 198 F. 2d. 697, cert. den'd. 344 U. S. 909).

It can no longer be doubted that this plenary action in which petitioners' expenses were incurred involved only rights created by the laws of New York.

As was said by this Court in *National Mut. Ins. Co.* v. *Tidewater Co.*:[35]

> "* * * The only way in which any law of the United States contributed to the [*Austrian*] case was in opening the district courts to the trustee * * * *. The fact that the congressional power over bankruptcy granted by Art. I could open the court to the trustee does not mean that such suits arise under the laws of the United States; but it does mean that Art. I can supply a source of judicial power for their adjudication. The distinction is important and it is decisive on this issue."

It may be added that the New York statute also expressly authorizes trustees in bankruptcy to bring suits against directors of corporations for relief, as claimed in this action.[36]

The New York statutes[37] providing for indemnity for defendants' expenses and for the assessment thereof are substantially the same as considered by this Court in *Cohen* v. *Beneficial Loan Corp.*[38]

Following the leadership of New York, a number of other states have enacted substantially the same statutory provisions for assessment of expenses of successful defendants made parties to an action by reason of the fact that they were directors of a corporation.[39]

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[35] 337 U.S. 582, at p. 599.

[36] Secs. 60, 61 General Corporation Law of New York.

[37] Article 6-A General Corporation Law of New York.

[38] 337 U.S. 541.

[39] California General Corporation Law, §§830, 834; Maryland Corporation Law, §58; Maryland General Laws, Art. 16, §206 (corporation may demand security); New Jersey General Corporation Law, §14: 3-14; 12 Purdon's Pennsylvania Statutes, §§1322 (security for costs), 1323 (assessment); Wisconsin Stat., §1813 (1945).

As pointed out by this Court in the *Cohen* case ar previously in *Erie* v. *Tompkins*,[40] the Congressional d rection that the laws of the states are applicable in th federal courts is the Rules of Decision Act.[41]

In the extension of the *Erie* doctrine this Court ha recognized that the state laws apply even where the ju isdiction is not founded upon diversity of citizenshi (*Wichita Royalty Co.* v. *City National Bank*, 306 U. S 103, 107, an action to wind up the affairs of a Nationa Bank). And the doctrine has been applied in numerou cases in district courts and in courts of appeals exercisin bankruptcy jurisdiction.[42]

Furthermore, the Rules of Decision Act has traditionall been understood to apply in non-diversity as well as i diversity cases (*Campbell* v. *Haverhill*, 155 U. S. 610 *Chattanooga Foundry & Pipe Works* v. *Atlanta*, 203 U. S 390, 399).[43] Thus, at this date, the Rules of Decision Act as construed in the *Erie* case, would seem to be applicable to non-diversity cases, whether in law or in equity, and under *Williams* v. *Austrian*, *supra*, this would include proceedings in bankruptcy.

As shown above, there are no provisions in the Bank ruptcy Act which preclude a bankruptcy court from apply-

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[40] 304 U.S. 64.

[41] 28 U.S.C.A., Sec. 1652, 62 Stat. 944: "The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply."

[42] See "The Erie Doctrine in Bankruptcy", 66 Harvard Law Review, page 1013 [April, 1953], at p. 1034, note 89.

[43] In the 1948 revision of the Judicial Code, the limitation of the Rules of Decision and to trials at common law was amended to make the Act applicable to civil suits generally, in recognition of the merger of law and equity in the federal rules of civil procedure and of the further fact that the substantive provisions of the Act had always been followed in equity (See Revisor's note at 28 U.S.C.A., §1652 (1950)).

ing the state statutory provisions allowing successful defendants their litigation expenses. Moreover, federal district courts sitting in bankruptcy have been scrupulous in having regard for state-created rights.[44]

The decision below, therefore, also presents an important question concerning federal and state regulations in connection with plenary suits brought by Chapter X trustees which has not been, but should be, decided by this Court.

IV

The Court of Appeals has decided a federal question in a way which conflicts with the decision of this Court in *Cohen* v. *Beneficial Loan Corp.*, 337 U. S. 541.

In the *Cohen* case, this Court had occasion to consider the applicability in the federal courts of a statute of the State of New Jersey which, as described in the Court's opinion, "makes the plaintiff, if unsuccessful, liable for the reasonable expenses, including attorney's fees, of the defense and entitles the corporation to require security for their payment" (337 U. S. 541, at 543).

The New Jersey statute considered in the *Cohen* case is substantially the same as the provisions of Article 6-A of the New York General Corporation Law.

In the *Cohen* case, this Court held the constitutionality of the New Jersey statutory provision does contravene the federal Constitution and that statutes of this character are not "merely a regulation of procedure", but create "a new liability where none existed before, * * *".[45]

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[44] See *supra*, note (43) and see also 3 COLLIER, BANKRUPTCY, §603.07 (14th Ed. 1940); 4 id. §2, 70.16, 70.18, 70.19, 70.70; 3 REMINGTON, BANKRUPTCY, §1212.03 (4th Ed. 1940); 4 id. §1613; 4-A id. §1728, 1730, 1754, 1755.

[45] 337 U. S. 541, at p. 555.

In substance, the liability created by the New Jersey statute considered in the *Cohen* case is no different from the liability created and imposed by Section 64 of the New York Corporation Law.[46]

In directing the dismissal of petitioners' applications, made in this action pursuant to the state statute, the decision of the Court below is in conflict with the decision of this Court in the *Cohen* case, and for that reason the decision below should be reviewed by this Court.

CONCLUSION

The important federal questions of the respective jurisdictions of federal district courts in different circuits exercising bankruptcy powers under the Bankruptcy Act and the application of state laws in federal courts having jurisdiction of a plenary action brought by Chapter X trustees in bankruptcy to enforce state-created rights, as decided by the Court below, warrants the granting of a writ of certiorari, as prayed herein.

Respectfully submitted,

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[46] Note (1), *supra*.

APPENDIX

The Statutes

Pertinent Provisions of Article 6—General Corporation Law of New York

JUDICIAL SUPERVISION OF CORPORATION AND OF THE OFFICERS AND MEMBERS THEREOF

"§60.[47] *Action against directors or officers of corporation for misconduct.*—An action may be brought against one or more of the directors or officers of a corporation to procure judgment for the following relief or any part thereof:

"1. To compel the defendants to account for their official conduct, including any neglect of or failure to perform their duties, in the management and disposition of the funds and property, committed to their charge.

"2. To compel them to pay to the corporation, or to its creditors, any money and the value of any property, which they have acquired to themselves, or transferred to others, or lost, or wasted, by or through any neglect of or failure to perform or other violation of their duties.

"3. To suspend a defendant from exercising his office, for an abuse of his trust.

"4. To remove a defendant from office and to direct the filling of the vacancy in accordance with the charter and by-laws of the corporation, or, if they contain no provision therefor, in such manner as the court shall direct.

"5. To set aside a transfer of property, made by one or more directors or officers of a corporation, contrary to

[47] L. 1929 c. 650 §1, as amended L. 1944 c. 727 §1.

a provision of law, where the transferee knew the purpose of the transfer.

"6. To enjoin such a transfer where there is good reason to apprehend that it will be made."

• • • • •

"§61.[48] *Who may bring such action.*—An action may be brought for the relief prescribed in section sixty of this chapter, by * * * the corporation or a creditor, receiver or trustee in bankruptcy thereof, or by a director or officer of the corporation."

• • • • •

Pertinent Provisions of Article 6-A of The General Corporation Law of New York[49]

Reimbursement of Litigation Expenses of Corporate Officials

"§64. *Assessment of expenses.*—Any person made a party to any action, suit or proceeding by reason of the fact that he, his testator or intestate, is or was a director, officer or employee of a corporation shall be entitled to have his reasonable expenses, including attorneys' fees, actually and necessarily incurred by him in connection with the defense of such action, suit or proceeding, and in connection with any appeal therein, assessed against the corporation or against another corporation at the request of which he served as such director, officer or employee, upon court order, in the manner and to the

[48] L. 1946 c. 162 §1.
[49] L. 1945 c. 869 §4.

extent provided by sections sixty-five, sixty-six and sixty-seven of this chapter, and in the instances specified in section sixty-eight of this chapter, except in relation to matters as to which it shall be adjudged in such action, suit or proceeding that such officer, director or employee is liable for negligence or misconduct in the performance of his duties."

"§65. *Application for payment or assessment of expenses.*—Application for payment of expenses under the provisions of a certificate of incorporation, or other certificate filed pursuant to law, by-law or resolution, or for assessment of expenses pursuant to section sixty-four of this chapter, may be made either (a) in the action, suit or proceeding brought in this state in which such expenses were incurred, or (b) to the supreme court in a separate proceeding. Such application shall show the disposition of any previous application made to any court. If not made in the action, suit or proceeding in which the expenses were incurred, such application shall also show reasonable cause for failure to make application in such action, suit or proceeding."

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"§67. *When award to be made.*—If after hearing an application for payment or for assessment of expenses, the court shall find that the applicant, his testator or intestate was successful in whole or in part, or that the action against him has been settled with the approval of the court, the court shall grant such application in such amount as it shall find to be reasonable, and shall make an order directing the corporation to pay to the applicant the amount awarded; provided, however, that no award

of indemnity or assessment of expenses shall be made in any case where it shall appear (i) that the law of the state of incorporation of the corporation prohibits such indemnity or assessment, or (ii) that the award would be inconsistent with any action of the stockholders or members of the corporation taken prior to and in effect at the time of the accrual of the alleged cause of action; or (iii) if there has been a settlement approved by the court, that the award would be inconsistent with any condition with respect to payment of indemnity or assessment of expenses expressly imposed by the court in approving such settlement."

"§68. *When and by whom application may be made.*— Sections sixty-four, sixty-five, sixty-six and sixty-seven of this chapter shall apply to an application made to a court in this state in any of the following cases:

"(a) when the corporation against whom the application is made for assessment of expenses pursuant to section sixty-four or for payment of expenses under the provisions of a certificate of incorporation, or other certificate filed pursuant to law, by-law or resolution, is a domestic corporation or a corporation doing business in this state;

"(b) when such expenses were incurred in an action or proceeding maintained in a court in this state;

"(c) when the application is made by a resident of this state and the director, officer or employee was a resident of this state at the time of the accrual of the alleged cause of action asserted in the litigation in which such expenses were incurred."

Appendix

Pertinent Provisions of the Bankruptcy Act

CHAPTER II

Section 2.[50] Creation of Courts of Bankruptcy and Their Jurisdiction.

a. The courts of the United States hereinbefore defined as courts of bankruptcy are hereby created courts of bankruptcy and are hereby invested, within their respective territorial limits as now established or as they may be hereafter changed, with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in proceedings under this Act, in vacation, in chambers, and during their respective terms, as they are now or may be hereafter held, to—

(2) Allow claims, disallow claims, reconsider allowed or disallowed claims, and allow or disallow them against bankrupt estates;

(7) Cause the estates of bankrupts to be collected, reduced to money, and distributed, and determine controversies in relation thereto, except as herein otherwise provided, * * *; and where in a controversy arising in a proceeding under this Act an adverse party does not interpose objection to the summary jurisdiction of the court of bankruptcy, by answer or motion filed before the expiration of the time prescribed by law or rule of court or fixed or extended by order of court for the filing of an answer to the petition, motion or other pleading to which he is adverse, he shall be deemed to have consented to such jurisdiction;

(15) Make such orders, issue such process, and enter such judgments, in addition to those specifically provided

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[50] 11 U.S.C.A., sec. 11, 30 Stat. 545 as amended 52 Stat. 842, 66 Stat. 420.

for, as may be necessary for the enforcement of the provisions of this Act: *Provided, however,* That an injunction to restrain a court may be issued by the judge only;

(18) Tax costs and render judgments therefor against the unsuccessful party, against the successful party for cause, in part against each of the parties, and against estates, in proceedings under this Act;

* * *

b. Nothing in this section contained shall be construed to deprive a court of bankruptcy of any power it would possess were certain specific powers not herein enumerated.

CHAPTER X

SEC. 102.[51]—The provisions of chapters I to VII, inclusive, of this Act shall, insofar as they are not inconsistent or in conflict with the provisions of this chapter, apply in proceedings under this chapter: *Provided, however,* That section 23, subdivisions h and n of section 57, section 64, and subdivision f of section 70, shall not apply in such proceedings unless an order shall be entered directing that bankruptcy be proceeded with pursuant to the provisions of chapters I to VII, inclusive. For the purposes of such application, provisions relating to "bankrupts" shall be deemed to relate also to "debtors", and "bankruptcy proceedings" or "proceedings in bankruptcy" shall be deemed to include proceedings under this chapter. For the purposes of such application the date of the filing of the petition in bankruptcy shall be taken to be the date of the filing of an original petition under section 128 of

[51] 11 U.S.C.A., sec. 502, 52 Stat. 883.

this Act, and the date of adjudication shall be taken to be the date of approval of a petition filed under section 127 or 128 of this Act except where an adjudication had previously been entered.

Sec. 111.[52] Where not inconsistent with the provisions of this chapter, the court in which a petition is filed shall, for the purposes of this chapter, have exclusive jurisdiction of the debtor and its property, wherever located.

Sec. 221.[53] The judge shall confirm a plan if satisfied that—

(1) the provisions of article VII, section 199, and article X of this chapter have been complied with;

(2) the plan is fair and equitable, and feasible;

(3) the proposal of the plan and its acceptance are in good faith and have not been made or procured by means or promises forbidden by this Act;

(4) all payments made or promised by the debtor or by a corporation issuing securities or acquiring property under the plan or by any other person, for services and for costs and expenses in, or in connection with, the proceeding or in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable or, if to be fixed after confirmation of the plan, will be subject to the approval of the judge; and

(5) the identity, qualifications, and affiliations of the persons who are to be directors or officers, or voting trustees, if any, upon the consummation of the plan, have been fully disclosed, and that the appointment of such persons to such offices, or their continuance therein, is equitable,

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[52] 11 U.S.C.A., sec. 511, 52 Stat. 884.
[53] 11 U.S.C.A., sec. 621, 52 Stat. 897.

compatible with the interests of the creditors and stockholders and consistent with public policy.

SEC. 241.[54] The judge may allow reimbursement for proper costs and expenses incurred by the petitioning creditors and reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in a proceeding under this chapter—

(1) by a referee;

(2) by a special master;

(3) by the trustee and other officers, and the attorneys for any of them;

(4) by the attorney for the debtor; and

(5) by the attorney for the petitioning creditors.

Such compensation of referees and trustees shall not be governed by sections 40 and 48 of this Act.

SEC. 242.[55] The judge may allow reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred in connection with the administration of an estate in a proceeding under this chapter or in connection with a plan approved by the judge, whether or not accepted by creditors and stockholders or finally confirmed by the judge—

(1) by indenture trustees, depositaries, reorganization managers, and committees or representatives of creditors or stockholders;

(2) by any other parties in interest except the Securities and Exchange Commission; and

(3) by the attorneys or agents for any of the foregoing except the Securities and Exchange Commission.

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[54] 11 U.S.C.A., sec. 641, 52 Stat. 900.
[55] 11 U.S.C.A., sec. 642, 52 Stat. 900.

Appendix

Opinion of United States Court of Appeals, Second Circuit

Before CLARK, HINCKS and HARLAN, Circuit Judges.

HARLAN, Circuit Judge.

These appeals are another chapter in a protracted series of litigations growing out of proceedings for the reorganization of Central States Electric Corporation, a Virginia corporation, which were initiated by the filing of a petition under Chapter X of the Bankruptcy Act, 11 U.S.C. § 501 et seq., 11 U.S.C.A. § 501 et seq., in the United States District Court for the Eastern District of Virginia on February 23, 1942, and approved by that Court on February 27, 1942.

Pursuant to an order of the Virginia Reorganization Court, on July 5, 1945 Carl J. Austrian and Robert G. Butcher, as Trustees of Central States, filed an action in the Southern District of New York, where Central States was doing business, against its officers, directors and principal stockholder charging them with various derelictions in their handling of Central States' affairs. A lengthy trial before Judge Weinfeld resulted in a dismissal of the action against the defendants who are parties to the present appeals, viz., Fogarty, Freeman, Johnson, McCornack, Eccles, Baker and Jonas (deceased and now represented by his Executor Pasternak), and also against the other defendants, not parties to these appeals, except Harrison Williams and Louis E. Kilmarx as to whom a judgment in excess of $14,000,000 was entered. See Austrian v. Williams, D.C.S.D.N.Y.1952, 103 F.Supp. 64. The District Court reserved jurisdiction to deal, among

other things, with "costs, expenses and allowances." On appeal by Williams to this Court, the judgment was reversed (Clark, C. J., dissenting) on the ground that the action was barred under both the 6 and 10-year New York statutes of limitation, N.Y.Civil Practice Act § 48, subd. 3, and § 53. See Austrian v. Williams, 2 Cir., 198 F.2d 697, certiorari denied 1952, 344 U.S. 909, 73 S.Ct. 328, 97 L.Ed. 701.

Following the successful result of the Trustees' action as to them, the seven defendants who are parties to these appeals brought on applications before Judge Weinfeld for allowances of expenses and attorneys' fees in that action. Except as to Jonas, all of these applications were made pursuant to Article 6A, §§ 63-68, of the General Corporation Law of New York, McKinney's Consol.Laws. c. 23, which provides that directors, officers or employees of corporations who have successfully defended their official conduct in an action brought by or on behalf of their corporation may recover from the corporation their reasonable expenses and attorneys' fees incurred in such action. Jonas, who was never a director, officer or employee of Central States, addressed his application to the general equity powers of the District Court.

Upon these applications, Judge Weinfeld made allowances in various amounts, aggregating some $45,000, and his action has resulted in the following appeals: (1) the Trustees appeal from the District Court's order and judgment of October 17, 1953 granting the allowances, contending that the Court was without power to make any of them; (2) Jonas (Pasternak) appeals from so much of the order and judgment of October 17, 1953 as limits his allowance to $3,500; and (3) Fogarty and

Freeman appeal from the District Court's order of December 10, 1953 vacating a separate judgment, dated November 4, 1953, covering the allowances in their favor. The Securities and Exchange Commission has appeared as *amicus curiae* and has furnished us with a helpful brief.

We come first to the appeal of the Trustees so far as it relates to the allowances made under Article 6A of the New York General Corporation Law. The District Court held that application of the New York Statute followed from the decision of this Court in Austrian v. Williams, 2 Cir., 198 F.2d 697, certiorari denied 1952, 344 U.S. 909, 73 S.Ct. 328, 97 L.Ed. 701, holding the action herein barred by the New York Statute of Limitations. The District Court further held that it, rather than the Virginia Reorganization Court, was the proper forum for the determination of these claims to reimbursement, but stated in its opinion that the order would not direct enforcement of the allowances as that was a matter for the Reorganization Court. Austrian v. Williams, D.C.S.D.N.Y., 120 F. Supp. 900, decision of Judge Weinfeld, August 21, 1953.

The District Court evidently read our decision on the limitations question as extending the doctrine of such cases as Erie R. Co. v. Tompkins, 1938, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188, and Cohen v. Beneficial Industrial Loan Corp., 1949, 337 U.S. 541, 69 S.Ct. 1221, 93 L.Ed. 1528, which require the application of State "substantive" law by Federal courts in diversity cases, to cases where although, as here, jurisdiction depends on a Federal ground independent of diversity [see Williams v. Austrian, 1947, 331 U.S. 642, 67 S.Ct. 1443, 91 L.Ed. 1718] the cause of action involved seeks enforcement of a State-created right.

This is a mistaken view of our decision. We held the New York Statute applicable in its full sweep in accordance with New York's decisional rules because of the provisions of Section 11, sub. e, of the Bankruptcy Act, 11 U.S.C. § 29(e), 11 U.S.C.A. § 29, sub. e, making State statutes of limitation applicable to suits instituted by a receiver or bankruptcy trustee where no Federal period of limitation existed. The New York Statute, rather than the Virginia Statute of Limitations, was held to apply since even if the causes of action sued upon were to be regarded as stemming from the law of Virginia (where Central States was incorporated), nonetheless under the conflicts of law rule the governing statute of limitations is that of the forum.

In this instance, we have no provision of the Bankruptcy Act which directs the application of any state laws providing for the recovery of expenses by defendants who have successfully defended actions brought against them. The question of whether there are other reasons why Article 6A should be applied therefore must turn on considerations which were not reached by this Court in its decision as to the statute of limitations. However, we think that we need not and should not decide this question since we are of the opinion that in no event did the District Court have jurisdiction to consider or make any of the allowances. This was a function belonging exclusively to the Virginia Reorganization Court.

The administration of the estate of a bankrupt or debtor belongs exclusively to that Court which has acquired jurisdiction over its affairs. While the Plan of Reorganization of Central States is not before us, it appears that

it has been finally approved and consummated *except* for the winding up of the action against the Central States directors which, together with other contingent assets of the Debtor, was retained in the hands of the Trustees. Funds were also reserved in the hands of the Trustees to provide for "allowances and expenses * * * in retaining and enforcing the contingent assets of the Estate, and in distributing the proceeds thereof." See Austrian v. Williams, D.C.S.D.N.Y., 120 F.Supp. 900, decision of Judge Weinfeld, August 21, 1953; Central States Electric Corp. v. Austrian, 4 Cir., 1950, 183 F.2d 879, 882, certiorari denied 1951, 340 U.S. 917, 71 S.Ct. 350, 95 L.Ed. 662; Chase v. Austrian, 4 Cir., 189 F.2d 555, certiorari denied 1951, 341 U.S. 952, 71 S.Ct. 1021, 95 L.Ed. 1374. The determination of these claims of the successful defendant-directors for reimbursement of their expenses in that action—constituting as they did claims against the assets of the Debtor remaining in the hands of the Virginia Reorganization Court—lay, we think, within the exclusive jurisdiction of the Reorganization Court. Brown v. Gerdes, 1944, 321 U.S. 178, 64 S.Ct. 487, 88 L.Ed. 659.

In the Brown case the attorneys for the Trustees of a Chapter X Debtor brought a proceeding in the New York courts under § 475 of the New York Judiciary Law, McKinney's Consol.Laws, c. 30, to establish a lien for their fees in a number of actions in the New York courts instituted under the authority of the Reorganization Court, in which they had represented the Debtor, and later the Trustees, until their services had been terminated by the Trustees before final judgment in any of the actions had been entered. The Supreme Court, confirming a decision of the New York Court of Appeals, In re Brown, 290 N.Y.

468, 49 N.E. 2d 718, held that the New York courts had no jurisdiction to determine the attorneys' fees, because Chapter X of the Bankruptcy Act had committed that function exclusively to the Reorganization Court.

We do not think that the force of that case is lessened here by reason of the fact that Brown was concerned with the compensation of the attorneys for the estate, whereas in the present case the allowances related to expenses and attorneys' fees of former directors of the Debtor. These allowances were nonetheless payable out of the Debtor's estate, and Chapter X "contains detailed machinery governing all claims for allowances from the estate." Brown v. Gerdes, supra, 321 U.S. at page 182, 64 S.Ct. at page 489. Indeed, so paramount is a reorganization court's jurisdiction over allowances which may affect the administration of the estate that the Supreme Court has held that such jurisdiction extends to allowances for services performed by attorneys for a stockholders' committee in a reorganization proceeding, even though not payable out of the estate. Leiman v. Guttman, 1949, 336 U.S. 1, 69 S.Ct. 371, 93 L.Ed. 453.

Nor is the impact of the Brown and Leiman cases affected by the fact that the claims of the defendant-directors were grounded on the State statute. Even if it be assumed that the doctrine of Cohen v. Beneficial Industrial Loan Corp., supra, should be extended to carry into this action the right of reimbursement given by Article 6A, we find nothing in that case which would divest the Reorganization Court of jurisdiction to pass upon these claims. At most, Cohen would reach only the "substantive" aspects of Article 6A, that is the right of the successful defendant-directors to reimbursement, and not its

"procedural" aspects—that is, the manner or forum in which such right is to be enforced.

A different conclusion as to *jurisdiction* might possibly be reached if the Trustees' cause of action under New York law had been conditioned upon the rights of reimbursement from the corporation (now the Debtor) which the successful defendant-directors sought to enforce in this action. Perhaps then it could have been argued that the submission of the main controversy to the Federal Court in New York carried with it also the submission of the controversy as to the rights of reimbursement. But since under the New York statute (unlike the New Jersey statute involved in the Cohen case) the plaintiffs' rights stood quite apart from the defendants' rights to reimbursement, we think that such an argument is not available here. Perhaps we should say that we intend no intimation of our views as to the applicability or non-applicability of Article 6A in this case, for we consider this a question for the Reorganization Court in the event that the applications for reimbursement are renewed there.

For the same reasons, we do not reach the propriety of the allowance made to Jonas (Pasternak) which the District Court thought justified under its general equity power, as exemplified in such cases as Sprague v. Ticonic Nat. Bank, 1939, 307 U.S. 161, 59 S.Ct. 777, 83 L.Ed. 1184; Rolax v. Atlantic Coast Line R. Co., 4 Cir., 1951, 186 F.2d 473, and Cleveland v. Second Nat. Bank & Trust Co., 6 Cir., 1945, 149 F.2d 466. Here again we think that exclusive jurisdiction to entertain and dispose of the Jonas (Pasternak) application is in the Virginia Reorganization Court.

The District Court concluded: "The present disposition [the making of the allowances] will in nowise conflict with the administration in the Bankruptcy Court. The order to be entered herein will determine the liability of the corporation [the Debtor] but will not direct its enforcement. That is a matter for the Bankruptcy Court." But we think that this overlooks the fact that the Bankruptcy Court's jurisdiction was not limited to mere enforcement—it also had the sole power to determine and measure the rights of the defendants to reimbursement.

Because of the conclusion we have reached on the main appeal of the Trustees, it becomes unnecessary for us to discuss separately the cross appeal of Jonas (Pasternak) from the order and judgment of October 17, 1953, or the appeals of Fogarty and Freeman from the order of December 10, 1953.

On appeal of plaintiffs-appellants, and on cross appeal of defendant-appellant Pasternak, order and judgment reversed and proceedings in the District Court dismissed for lack of jurisdiction, without prejudice to renewal of the applications for allowances in the United States District Court for the Eastern District of Virginia; on appeal of defendants-appellants Freeman and Fogarty, order affirmed and proceedings in the District Court for separate judgment dismissed for lack of jurisdiction.

ON REARGUMENT.

In our original opinion disposing of these appeals we held that the District Court for the Southern District of New York was without jurisdiction to pass upon these applications for allowances, such jurisdiction resting entirely with the Virginia Reorganization Court. The further

contentions, on reargument, of the unsuccessful parties have failed to convince us to the contrary. Certain of their arguments, however, warrant some elaboration of what was said in our original opinion.

The principal contention is that Southern District jurisdiction to deal with the allowances involved results from the earlier decisions of this Court and the Supreme Court in Austrian v. Williams, 2 Cir., 1946, 159 F.2d 67, and Williams v. Austrian, 1947, 331 U.S. 642, 67 S.Ct. 1443, 91 L.Ed. 1718, in which it was held that under Section 2, sub. a(7) of the Bankruptcy Act, 11 U.S.C.A. § 11 sub. a (7), the Southern District Court had jurisdiction to entertain the plenary action out of which the present applications for allowances arose. It is said that these applications being merely an incident of such a plenary action under Art. 6-A of the New York Corporation Law, McKinney's General Corporation Law, § 63 et seq., it follows that the Southern District Court also had jurisdiction to deal with them, especially since subdivision a(2) and (18) of the same section of the Bankruptcy Act give courts of bankruptcy power to allow claims and to tax costs against bankrupt estates in proceedings brought under the bankruptcy laws. We cannot agree.

All that these earlier cases decided was that since the limitations of § 23 of the Bankruptcy Act, 11 U.S.C.A. § 46, do not apply in a Chapter X, 11 U.S.C.A. § 501 et seq., proceeding, a Chapter X trustee may under § 2, sub. a(7) sue in any federal court having personal jurisdiction of the defendants upon any cause of action belonging to the estate, even though no independent ground of federal jurisdiction exists. These cases did not decide that the reorganization court and all other federal courts have

concurrent jurisdiction to exercise *every* bankruptcy power applicable to a Chapter X proceeding. Indeed, in Williams v. Austrian the Supreme Court, 331 U.S. at page 647, 67 S.Ct. at page 1445, noted that "certain aspects of a bankruptcy proceeding could be handled only by the court in which the [bankruptcy] adjudication was had * * *.". Nor did these cases reach the question as to whether the powers contained in section 2, subdivision a(2) and (18) might also be exercised by the Southern District Court.

We think that jurisdiction to make the ultimate disposition of these applications—whether based on Art. 6-A or upon the general equity powers of the court—was exclusively reserved to the Virginia Reorganization Court under § 221(4) of the Bankruptcy Act, 11 U.S.C.A. § 621(4), as the Securities and Exchange Commission has persuasively argued. That section provides that the reorganization judge shall confirm a plan "if satisfied that—* * * (4) all payments made or promised by the debtor * * * for services and for costs and expenses * * * in connection with the plan and incident to the reorganization, have been fully disclosed to the judge and are reasonable or, if to be fixed after confirmation of the plan, will be subject to the approval of the judge". These allowances were payable "by the debtor". Arising out of a lawsuit which was a potential asset of the estate and involved in the plan, they were "in connection with the plan and incident to the reorganization". And being fixable after confirmation of the plan, they were "subject to the approval of the [reorganization] judge".

We find nothing in § 221(4) which limits its application to expenses incurred or services performed by parties to the reorganization or their attorneys. On the contrary,

Leiman v. Guttman, 1949, 336 U.S. 1, 8, 69 S.Ct. 371, 93 L.Ed. 453, characterized the terms of this section as "pervasive," and it would be quite inconsistent with the rationale of Leiman and Brown v. Gerdes, 1944, 321 U.S. 178, 64 S.Ct. 487, 88 L.Ed. 659, to interpret the language of § 221(4) short of its full scope. Indeed, the situation here, where these allowances were payable out of the estate, is *a fortiori* to that in Leiman, where the payments involved did not go against the estate.

Since § 221(4) vests the ultimate disposition of these applications in the Virginia Reorganization Court, it was error for the New York Court to grant any judgment with respect to them. We do not think that such error is obviated by the fact that the Court below left the "enforcement" of its judgment to the Virginia Court. If, as counsel for some of the defendants suggested on oral argument, this means that the Virginia Court's function would be limited to the mere adjustment of the burden of the allowances as between the security holders of the debtor such a limitation would surely run afoul of § 221(4). On the other hand, were we to interpret the judgment below as permitting the Virginia Court to reduce the allowances or to set them aside entirely, we think this would nonetheless impinge upon that Court's exclusive control over the administration of the debtor's estate and the plan. See Section 111 of Chapter X, 11 U.S.C.A. § 511. For example, the Virginia Court would be faced with providing for the expense of resisting these claims in two courts, since the Trustees could scarcely be taken to have defended against the claims in the Southern District at the peril of not being compensated. Moreover, if notwithstanding the Southern District judgment the Virginia Court would still

be free to deal with these applications *de novo,* it is hard to see what useful purpose the Southern District proceedings would have served. The consideration that the Southern District, rather than the Virginia, Court was in the better position to appraise what was done in defending the litigation is one which was equally present in Brown v. Gerdes.

It is also said that the mere bringing of this suit in the Southern District Court operated to confer jurisdiction over these allowances, since liability for the expenses of the successful defendant-directors was, under Art. 6-A, a condition attaching to the Trustees' cause of action. But as stated in our original opinion, which we consider unnecessary to elaborate in this respect, we do not think such liability can properly be regarded as conditioning the cause of action itself, either under the terms of Art. 6-A or under the rationale of Cohen v. Beneficial Indus. Loan Corp., 1949, 337 U.S. 541, 69 S.Ct. 1221, 93 L.Ed. 1528. Moreover, even were this possible liability considered as a condition, imposed by the New York legislature, upon the right to sue, whatever efficacy such a condition might have would be limited to suits in the New York State Courts. It would not have the effect of conditioning the Trustees' right to invoke Southern District jurisdiction over this plenary action, which is a jurisdiction conferred by the Bankruptcy Act. It may be that a liability for costs is generally a condition to suit. But the scope of costs in federal courts is determined only by federal law which does not classify the allowances and expenses here involved (including that to Jonas under the general equity powers of the court[1]) as ordinary allowable costs. Such

1. See People of Sioux County, Neb. v. National Surety Co., 1928, 276 U.S. 238, 241-44, 48 S.Ct. 239, 72 L.Ed. 547.

allowances and expenses may have an impact upon the administration of an estate or a plan of reorganization which ordinary costs do not have because of their comparatively nominal amount. Consequently, from the fact that the Trustees by suing in the federal court subject the estate to the costs taxable in a federal court, it would not follow that the federal court in which this suit was brought would have jurisdiction to determine a liability arising as a condition to suit in a court of the State. By this we do not mean to express any view as to the validity of a defendant's state-created right to reimbursement or the enforceability of that right in a federal court of competent jurisdiction. We simply hold that when, as here, it arises out of an action brought by a trustee of a debtor in reorganization under Chapter X of the Bankruptcy Act, only the Reorganization Court has jurisdiction to determine and enforce the right to reimbursement.

This conclusion is, we think, quite in harmony with the scheme of things of Art. 6-A, under which in State actions applications for reimbursement may be made either in the trial Court or, for "reasonable cause," in the New York Supreme Court. For it would seem that when such an action is tried in a federal court other than the reorganization court there are ample reasons why such applications should be made in the reorganization instead of the trial court, and that such procedure is the substantial equivalent of an application in a State litigation which is made in the Supreme Court for "reasonable cause," rather than in the court where the action was tried. But if what we have held nonetheless be considered to offend against Art. 6-A, it need only be said that the State statute must yield to the supremacy of the bankruptcy laws.

Finally, we do not think that in bringing a plenary suit against former officers of the debtor, the Trustees were "carrying on business" of the debtor, so that under 28 U.S.C.A. § 959 they might have forfeited their immunity from suit, and become exposed to liability in any court, state or federal, where the controversy might be heard if the Trustees were ordinary businessmen. Merely to attempt to collect and liquidate the assets of a debtor is not to carry on its business in any proper sense of the term. See Vass v. Conron Bros., 2 Cir., 1932, 59 F.2d 969. We consequently are not required to reach the question, subject to some dispute, of the exact effect of 28 U.S.C.A. § 959 on Chapter X proceedings, as distinguished from ordinary bankruptcy proceedings. See 6 Collier on Bankruptcy 744-48.

For these reasons we adhere to our original decision on these appeals.